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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

KRISTIN K. MAYES - CHAIRMAN
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

2009 AUG -5 P 4: 04

AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF
UNS GAS, INC. FOR THE ESTABLISHMENT
OF JUST AND REASONABLE RATES AND
CHARGES DESIGNED TO REALIZE A
REASONABLE RATE OF RETURN ON THE
FAIR VALUE OF THE PROPERTIES OF UNS
GAS, INC. DEVOTED TO ITS OPERATIONS
THROUGHOUT THE STATE OF ARIZONA.

) DOCKET NO. G-04204A-08-0571

**NOTICE OF FILING
REJOINDER TESTIMONY**

UNS Gas, Inc., through undersigned counsel, hereby files the Rejoinder Testimony of David G. Hutchens, Kentton C. Grant, Dallas J. Dukes, and D. Bentley Erdwurm in the above-captioned docket.

RESPECTFULLY SUBMITTED this 5th day of August 2009.

UNS Gas, Inc.

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Arizona Corporation Commission
DOCKETED

AUG - 5 2009



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2 filed this 5th day of August, 2009, with:

3 Docket Control
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8 this 5th day of August, 2009, to:

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UNS GAS, INC.
REJOINDER TESTIMONY

August 5, 2009

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

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14 GAS, INC. DEVOTED TO ITS OPERATIONS)
15 THROUGHOUT THE STATE OF ARIZONA.)

16 Rejoinder Testimony of

17 David G. Hutchens

18 on Behalf of

19 UNS Gas, Inc.

20 August 5, 2009

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1 **I. INTRODUCTION.**

2
3 **Q. Please state your name and address.**

4 A. My name is David G. Hutchens. My business address is One South Church Avenue,
5 Tucson, Arizona 85701.

6
7 **Q. Did you file Direct and Rebuttal Testimony in this proceeding?**

8 A. Yes. I filed Direct and Rebuttal Testimony and have also adopted the Direct Testimony of
9 Mr. Gary Smith.

10

11 **Q. On whose behalf are you filing your Rejoinder Testimony in this proceeding?**

12 A. My Testimony is filed on behalf of UNS Gas, Inc.

13

14 **Q. Please summarize your Rejoinder Testimony?**

15 A. First, I respond to certain incorrect statements and mischaracterizations by Staff witness
16 Dr. Thomas Fish regarding the Company's capital investments made since December
17 2005, the end of last UNS Gas rate case. I also respond to Dr. Fish's continuing use of an
18 estimated growth rate from last fall that simply no longer reflects reality.

19

20 Second, I accept the clarifications to the recommendations made by Staff witness Rita
21 Beale in her Direct Testimony.

22

23 **II. RESPONSE TO SURREBUTTAL TESTIMONY OF THOMAS FISH.**

24

25 **Q. What has Dr. Fish stated regarding the Company's capital investment?**

26 A. Dr. Fish states (p. 13 of Surrebuttal) that:

27

1 It is clear that existing customers are being asked to pay for \$36 million in
2 capital investment that is not necessary for the Company's provision of
3 service to them. That investment, according to the Company, was made to
4 provide service to customers who do not exist and, according to the
5 Company, may or may not exist at some time in the future.

6 **Q. What is incorrect about these statements?**

7 A. Dr. Fish misconstrues Company witness statements to come to the conclusion that
8 somehow the Company has provided information that states the capital investment for
9 growth was made for customers that do not exist. In essence, Dr. Fish appears to be
10 saying these costs are not used and useful.

11 **Q. How is this incorrect?**

12 A. The Company's capital investments were made to serve *new*, not future customers. The
13 amount attributed to growth in my Direct Testimony simply delineated the value of the
14 plant put into service since December 2005 to connect to and serve new customers versus
15 the capital spent on system improvements that benefited the existing customer base. New
16 customers are real customers, not hypothetical future customers.

17
18 **Q. Does Dr. Fish's Surrebuttal Testimony contradict Staff Witness Mr. Corky Hanson's**
19 **Direct Testimony?**

20 A. Yes. Dr. Fish implies that \$36 million in capital investment by the Company was not
21 used and useful and Mr. Hanson clearly states that it is used and useful.

22
23 **Q. Is Staff recommending that an adjustment to rate base be made based on Dr. Fish's**
24 **statements?**

25 A. No. Staff has not recommended any adjustment to rate base as a result of Dr. Fish's
26 statements.

1 **Q. Are there other flaws to Dr. Fish argument?**

2 A. Yes. Dr. Fish implies that a Company with no, or low, overall net customer growth
3 cannot have growth related expenses. This is factually incorrect. A company could be
4 adding new customers to its system and be losing an equal number of existing customers
5 with the net result of "no growth". One can clearly see that a company in this situation
6 would still have growth related investments. This may be particularly true where a
7 company provides service to a broad, yet diverse, area.

8
9 **Q. Is this what the Company is experiencing?**

10 A. To some extent. We still have new customers hooking up to our systems but we are also
11 losing a number of customers. The net of which is a lower overall customer growth rate
12 and growth related expenses that are higher than would be expected if you looked at
13 overall (or net) customer growth. Moreover, in this economy, lost customers can be
14 particularly exacerbated in a situation where your service area includes a significant
15 number of second homes or investor-owned homes.

16
17 **Q. Dr. Fish continues to rely on a 2.5% growth estimate for UNS Gas from last fall. Is**
18 **that reliance appropriate?**

19 A. No. That estimate is outdated and reflected a 10-year average growth level as estimated
20 last fall. It was not intended to reflect a short-term growth estimate. Even UNS Gas' one-
21 year growth estimate from last fall (1.0%) ended up being significantly overstated to what
22 occurred (-0.1%) Indeed, as set forth in Mr. Erdworm's Rebuttal Testimony, there has
23 been no short-term growth in our service area. Moreover, recent growth estimates have
24 decreased significantly. For example, UNS Gas does not expect more than a 0.6% average
25 annual growth over the next three years. But that number could change significantly again,
26
27

1 depending on a variety of factors. Such variability is one reason why growth estimates
2 simply are inappropriate for customer annualization calculations.

3
4 **III. RESPONSE TO SURREBUTTAL TESTIMONY OF RITA BEALE.**

5
6 **Q. Do you agree with the clarifications Ms. Rita Beale provided in her Surrebuttal**
7 **Testimony regarding her Direct Testimony Recommendations?**

8 **A.** Yes. Her clarifications fill in the gaps in my understanding of her recommendations and
9 will be implemented by the Company.

10
11 **Q. Does this conclude your Rejoinder Testimony?**

12 **A.** Yes, it does.
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Rejoinder Testimony of

Kentton C. Grant

on Behalf of

UNS Gas, Inc.

August 5, 2009

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1 **I. INTRODUCTION.**

2
3 **Q. Please state your name and address.**

4 A. My name is Kentton C. Grant. My business address is One South Church Avenue, Tucson,
5 Arizona.

6
7 **Q. Did you file Direct Testimony and Rebuttal Testimony in this proceeding?**

8 A. Yes.

9
10 **Q. On whose behalf are you filing your Rejoinder Testimony in this proceeding?**

11 A. My Testimony is filed on behalf of UNS Gas, Inc.

12
13 **Q. What is the purpose of your Rejoinder Testimony in this proceeding?**

14 A. The purpose of my Rejoinder Testimony is to respond to portions of the surrebuttal
15 testimony filed by Arizona Corporation Commission Staff ("Staff") witnesses David C.
16 Parcell, Thomas H. Fish and Robert G. Gray, as well as portions of the surrebuttal
17 testimony filed by Residential Utility Consumer Office ("RUCO") witnesses William A.
18 Rigsby and Ralph C. Smith.

19
20 **II. RESPONSE TO STAFF WITNESS DAVID C. PARCELL.**

21
22 **Q. What aspects of Mr. Parcell's Surrebuttal Testimony will you address in this**
23 **Rejoinder Testimony?**

24 A. My comments will focus on Mr. Parcell's characterization of recent developments in the
25 capital markets and his assertion that UNS Gas is somehow seeking a guaranteed return
26 on capital.

1 **Q. What does Mr. Parcell have to say regarding recent developments in the capital**
2 **markets?**

3 A. On page 4 of his Surrebuttal Testimony Mr. Parcell once again makes reference to the
4 recent "flight to safety" that has taken place in the debt and equity markets. However,
5 despite the increase in observed bond yields and large sell-off in common stocks, Mr.
6 Parcell continues to reject the notion that the cost of capital for utilities has increased.
7 Instead, he reiterates his belief that the flight to safety reflects more of an "availability of
8 capital" problem as opposed to a "cost of capital" problem.

9
10 **Q. Is this a realistic view of the capital markets?**

11 A. No. This view could only hold water if one were to suspend the laws of supply and
12 demand in the capital markets. It is simply unrealistic to believe that the cost of capital
13 for utilities could remain unchanged when the amount of capital made available to
14 utilities has been dramatically reduced through a massive flight to safety. The simple fact
15 of the matter is that required yields on U.S. Treasury securities plummeted while required
16 yields on utility bonds rose dramatically, especially for lower-rated utilities such as UNS
17 Gas. At the same time, even relatively stable sectors such as the gas utility industry
18 suffered large declines in stock prices. Mr. Parcell's decoupling theory, wherein the cost
19 of capital remains unaffected by the "availability of capital," is a phenomenon that is
20 contrary to both basic economic principles and empirical market data.

21
22 **Q. What does Mr. Parcell have to say with regard to the Company's ability to earn its**
23 **cost of capital?**

24 A. Not much. However, on page 7 of his Surrebuttal Testimony, he offers the following
25 observation:
26
27

1 Mr. Grant seems to be taking the position that the cost of
2 capital authorized by a commission should be regarded as a
3 "guarantee" but this is not the case. Utility investors have no
4 more "right" to a guaranteed return than do its ratepayers to a
5 "right" to employment, maintenance of their housing values,
6 and an increasing value of their retirement accounts and other
7 investments.

8 **Q. Is this a fair characterization of your testimony?**

9 A. No, it is not. All the Company is seeking is a reasonable opportunity to earn its cost of
10 capital. Even if UNS Gas' rate proposal were adopted in its entirety, the Company would
11 still be exposed to variability in sales, inflationary cost pressures, changes in tax policies,
12 shifting capital markets, new regulatory mandates and a host of other potential risks to its
13 financial outlook. Additionally, as demonstrated in my Rebuttal Testimony, the
14 Company forecasts that it would still not be able to earn its 11.0% cost of equity even if
15 the Commission were to grant the entire rate increase being sought by UNS Gas. Under
16 the circumstances, I find Mr. Parcell's characterization of my testimony to be very
17 misleading.

18 **III. RESPONSE TO STAFF WITNESS THOMAS H. FISH.**

19 **Q. Mr. Grant, what portion of Dr. Fish's Surrebuttal Testimony do you care to
20 address?**

21 A. My comments focus on Dr. Fish's discussion of the Company's working capital
22 requirements, and in particular, the reasonableness of the credit terms that existed
23 between UNS Gas and its sole natural gas supplier, BP Energy, during the test year.
24 Other aspects of Dr. Fish's Surrebuttal Testimony will be addressed by other UNS Gas
25 witnesses.
26
27

1 2008, the Company has started purchasing gas from other suppliers. However, it should
2 be noted that other suppliers are not providing generous amounts of credit to UNS Gas.
3 BP Energy still provides more trade credit to UNS Gas than any of the other gas suppliers
4 the Company is now doing business with.
5

6 **Q. Do you agree with Dr. Fish that the credit terms extended by BP Energy were “not**
7 **realistic” and “not representative of normal credit terms”?**

8 A. No. As stated above, BP Energy has extended more trade credit to UNS Gas than any
9 other supplier. Credit terms are negotiated between a buyer and seller as part of the
10 contracting process. Since BP Energy was the Company’s sole gas supplier during the
11 test year, and since UNS Gas’ credit profile is weaker than most gas utilities, it should not
12 be surprising that UNS Gas would bump up against this credit limit during peak periods
13 of gas usage. While the acceleration of payments to third party providers is not a very
14 common practice, in the case of UNS Gas it was a cheaper alternative relative to posting
15 cash collateral or providing a letter of credit.
16

17 **Q. Do you agree with Dr. Fish that the Company’s customers should not be responsible**
18 **for the incremental cost of providing credit support?**

19 A. No. The Company makes no profit on the sale of natural gas procured in the wholesale
20 market for retail customers. Since the Company is providing a valuable gas procurement
21 service that benefits its retail customers with no mark-up, it is hard to understand why Dr.
22 Fish believes that credit support costs incurred for gas procurement should not be
23 recouped by the Company.
24
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1 **IV. RESPONSE TO STAFF WITNESS ROBERT G. GRAY.**

2
3 **Q. What comments do you have in response to the Surrebuttal Testimony filed by Staff**
4 **witness Robert Gray?**

5 A. Mr. Gray cites the same reasons discussed in his Direct Testimony for denying the
6 Company's proposal to change the interest rate on bank balances under the Purchased Gas
7 Adjustor ("PGA") rate mechanism. However, on page 2 of his Surrebuttal Testimony, he
8 also implies that under the Company's proposal, the proposed interest rate would
9 somehow be applied differently to under- and over-recovered balances of purchased gas
10 costs.

11
12 **Q. Is the Company proposing to apply a one interest rate to over-recovered PGA bank**
13 **balances and a different interest rate to under-recovered PGA bank balances?**

14 A. No. Under UNS Gas' proposal, the same rate would be applied to both under- and over-
15 recovered bank balances. And since the proposed interest rate is higher than the rate
16 currently in place, customers would actually benefit from this proposal at the present time
17 due to the presence of an over-recovered PGA bank balance at UNS Gas.

18
19 **V. RESPONSE TO RUCO WITNESS WILLIAM A. RIGSBY.**

20
21 **Q. What comments do you have on the Surrebuttal Testimony filed by RUCO witness**
22 **William Rigsby?**

23 A. I will confine my comments to Mr. Rigsby's use of the Capital Asset Pricing Model
24 ("CAPM") to derive an estimate for the cost of equity capital. In his Surrebuttal
25 Testimony, Mr. Rigsby continues to defend his use of the CAPM, which resulted in a
26 ridiculously low cost of equity estimate of 5.26% to 6.39%. He also goes on to provide
27 an alternative CAPM analysis that produces an even lower range of 4.91% to 6.25%.

1 **Q. What did Dr. Fish have to say about the credit terms that existed between UNS Gas**
2 **and BP Energy during the test year?**

3 A. On page 4 of his Surrebuttal Testimony, Dr. Fish expressed an opinion that the credit
4 terms were "not realistic" and "not representative of normal credit terms." He goes on to
5 state that "UNS Gas has the discretion to obtain more favorable terms and conditions
6 from another supplier," and that UNS Gas customers should not have to bear the
7 incremental cost of these credit terms.
8

9 **Q. What aspect of these credit terms does Dr. Fish criticize?**

10 A. He criticizes the making of payments to BP Energy twice per month instead of on a
11 monthly basis as is customary. His main problem with the acceleration of payments is
12 that the Company's working capital requirements are higher than they would otherwise
13 be.
14

15 **Q. Did the Company have any alternatives it could have pursued in lieu of making**
16 **accelerated payments?**

17 A. Yes, but neither of these alternatives would have been cost effective. One of these
18 alternatives would have involved the posting of cash collateral with BP Energy for an
19 extended period of time. The other alternative would have required the issuance of a
20 bank letter of credit in the favor of BP energy. Both of these alternatives would have
21 been more costly than the accelerated payment plan.
22

23 **Q. Do you agree with Dr. Fish that UNS Gas had the discretion to obtain more**
24 **favorable terms from another supplier?**

25 A. No. During the test year, BP Energy was a full-requirements supplier to UNS Gas. Only
26 under very limited circumstances would the Company have been permitted to purchase
27 gas from another provider. Since the expiration of that full-requirements contract in mid-

1 Although Mr. Rigsby makes many technical arguments in support of his analysis, the end
2 result produced by his CAPM analysis is simply unrealistic.

3
4 **Q. Please explain why the results obtained from Mr. Rigsby's application of the CAPM**
5 **are unrealistically low.**

6 A. This point was initially addressed on page 20 of my Rebuttal Testimony, where I
7 described how it is unrealistic to expect the cost of equity capital to be lower than the cost
8 of debt for any given company. As described in his Direct Testimony, Mr. Rigsby agrees
9 with UNS Gas that the Company's embedded cost of debt is 6.49%. He also points out
10 on page 17 of his Surrebuttal Testimony that required returns on Baa/BBB rated utility
11 bonds were recently quoted at 6.85%. Therefore, using either the embedded cost of debt
12 for UNS Gas or the current market rate of debt for similar rated utilities, the CAPM
13 results obtained by Mr. Rigsby would imply the presence of a negative equity risk
14 premium (i.e., a cost of debt that exceeds the cost of equity).

15
16 **Q. Does Mr. Rigsby's Surrebuttal Testimony address the feasibility of a negative equity**
17 **risk premium?**

18 A. Yes. Page 16 of his Surrebuttal Testimony, lines 18-23, contains the following question
19 and answer:

20 Q. Please address Mr. Grant's argument that common
21 shareholders bear a higher risk than bond holders and expect a
higher return than the yields of utility debt instruments.

22 A. I do not disagree with Mr. Grant on this point. The
23 question is how much more of a risk premium is merited for a low
risk regulated monopoly such as UNS Gas.

24 Based on Mr. Rigsby's own testimony regarding the cost of debt and the lack of a
25 negative equity risk premium, it is apparent that the results he obtained from the CAPM
26 are unrealistically low and should therefore be afforded zero weight in determining the
27 Company's cost of equity.

1 **VI. RESPONSE TO RUCO WITNESS RALPH C. SMITH.**

2
3 **Q. What aspects of Mr. Smith's Surrebuttal Testimony will you respond to?**

4 A. My comments are focused on his discussion of the appropriate rate of return ("ROR") on
5 fair value rate base ("FVRB"). In particular, I will respond to his statements regarding
6 the appropriate use of financial forecasts in a rate proceeding, and his assertion that UNS
7 Gas' rate proposal represents an unwarranted burden on the Company's customers.
8

9 **Q. How does Mr. Smith characterize your use of financial forecasts in this proceeding?**

10 A. On page 12 of his Surrebuttal Testimony, lines 10-12, he infers that I am using financial
11 forecasts as "some kind of a surrogate for a future test year" or as "some kind of test of
12 the reasonableness of the parties' differing recommendations."
13

14 **Q. Is this characterization accurate?**

15 A. No. Although I am using the results of a financial forecast to gauge the reasonableness of
16 the rate increases recommended by each of the parties to this proceeding, I am certainly
17 not using the forecast as a "surrogate" for a future test year.
18

19 **Q. Please explain.**

20 A. As discussed by Mr. Smith as well as Staff witness David Parcell, the Commission has
21 some discretion in setting the ROR on FVRB. In recognition of this discretion, the rates
22 of return on FVRB recommended by the witnesses in this proceeding vary widely. In
23 order to gauge the reasonableness of these widely divergent rates of return, and the end
24 result arising from each party's revenue requirement, it is important to examine the
25 financial impact these recommendations will have on UNS Gas. The only meaningful
26 way do this, given that new rates will not be in place until late 2009 or early 2010, is to
27 examine a financial forecast for the period that new rates will be in effect. That is the

1 reason I included a financial forecast for UNS Gas in both my Direct and Rebuttal
2 Testimony. Without this information, I am not sure what basis the Commission would
3 have for adopting one value over another in its determination of a reasonable ROR on
4 FVRB. Alternatively, the Commission could adopt the same calculation methodology
5 approved for Chaparral City Water Company in Decision No. 70441. However, it is
6 apparent that there is no agreement between the Company, Staff and RUCO on what
7 would constitute a reasonable ROR on FVRB in this proceeding.
8

9 **Q. On pages 3 and 4 of his Surrebuttal Testimony, Mr. Smith discusses the criteria that**
10 **he believes should be applied in determining a reasonable ROR on FVRB. Do you**
11 **agree with the criteria applied by Mr. Smith?**

12 **A.** No, I do not. While the Company is certainly sympathetic to the plight of its customers
13 in such a tough economic environment, the basis for Mr. Smith's recommendation is
14 clearly one-sided. No consideration is given to the Company's need to recover its cost of
15 providing service and the opportunity to earn a reasonable rate of return on its capital
16 investment. Instead, Mr. Smith refers to any increment of revenue requirement over and
17 above that produced by an original cost rate base as a "fair value difference" and an
18 "extra revenue increase" that should be as close to zero as possible. He goes on to
19 characterize the "fair value difference" derived from the methodology adopted in
20 Decision No 70441 as "burdening" to ratepayers and resulting in a rate increase that is
21 "not warranted" for UNS Gas. In short, the only criteria being applied by Mr. Smith in
22 selecting a ROR on FVRB is the minimization of rates to UNS Gas customers.
23

24 **Q. Is the requested ROR on FVRB and corresponding rate increase "unwarranted" as**
25 **Mr. Smith claims?**

26 **A.** No, it is not. The Company's cost of service is clearly higher than the revenues produced
27 under current rates. Although the current economic environment is indeed very

1 challenging, and a rate increase would likely be viewed as an unwelcome burden by
2 many of the Company's customers, the simple fact of the matter is that UNS Gas
3 shareholders have also been burdened by below-market rates of return on their capital,
4 even during periods of relative economic prosperity. The approach being advocated by
5 Mr. Smith is decidedly asymmetrical. Under his approach, during poor economic times
6 such as these, it is perfectly acceptable for a public utility to earn less than its cost of
7 capital. However, during more prosperous times, the best a utility can expect to do is to
8 earn its cost of capital, and not a penny more. Such a policy would clearly not be in the
9 long-term best interest of UNS Gas or its customers, as it would serve to reduce the
10 amount of capital and credit made available to the Company, and increase the cost of
11 whatever capital and credit that is made available.

12
13 **Q. Does this conclude your Rejoinder Testimony?**

14 **A.** Yes, it does.
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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 **COMMISSIONERS**

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1 **I. INTRODUCTION.**

2
3 **Q. Please state your name and address.**

4 A. My name is Dallas J. Dukes. My business address is One South Church Avenue, Tucson,
5 Arizona.

6
7 **Q. On whose behalf are you filing your Rejoinder Testimony in this proceeding?**

8 A. My Testimony is filed on behalf of UNS Gas, Inc.
9

10 **Q. What is the purpose of your Rejoinder Testimony in this proceeding?**

11 A. The purpose of my Rejoinder Testimony is to address certain adjustments that Staff
12 Witness Dr. Thomas H. Fish ("Dr. Fish") discusses in his Surrebuttal Testimony. I also
13 address several adjustments that Residential Utility Consumer Office ("RUCO") witness
14 Mr. Ralph C. Smith ("Mr. Smith") discusses in his Surrebuttal Testimony.
15

16 **Q. Did you file Direct and Rebuttal Testimony in this proceeding?**

17 A. Yes
18

19 **II. REJOINDER TO RATE BASE ADJUSTMENTS.**

20
21 **A. Post Test Year Non Revenue Plant in Service.**

22
23 **Q. Do Staff and RUCO still disagree with the Company's inclusion of Post Test Year
24 Non Revenue Plant in Service within rate base?**

25 A. Yes. Staff's witness, Dr. Fish, and RUCO's witness, Mr. Smith, continue their objection
26 to including post test year plant in rate base.
27

1 **Q. Has the basis for Dr. Fish's or Mr. Smith's removal of the Company's Post Test Year**
2 **Non Revenue Plant in Service adjustment changed from that of their direct filings?**

3 A. No. Dr. Fish and Mr. Smith continue to argue that post-test year plant should not be
4 included in rate base with out conclusive proof that it is necessary to preserve the financial
5 health of the utility and complete assurance it is revenue-neutral, expense-neutral, prudent,
6 and necessary.

7
8 **Q. With that list of criteria in mind, do you believe UNS Gas would ever be allowed to**
9 **include Post Test Year Non Revenue Plant within rate base?**

10 A. Given the requirement to meet each of the standards as defined by Staff and RUCO, it is
11 unlikely that UNS Gas would ever qualify for inclusion of post test year plant. But the
12 Commission has approved post test year plant in a number of cases.

13
14 **Q. Do you agree with this standard?**

15 A. No. UNS Gas does not believe the Commission's discretion and judgment to include post
16 test year plant should be limited by Staff and RUCO's proposed standard. In Arizona we
17 use historical test years to set rates and we see at least a three year lag from the end of the
18 test year in one proceeding till new rates go into effect for the next proceeding. That is
19 why UNS Gas believes the Commission should consider the inclusion of post test year non
20 revenue producing plant in rate base as a reasonable adjustment. If Staff's and RUCO's
21 recommendations are adopted, the Company believes it will be necessary to file another
22 rate case in the near future.

23
24 **Q. Has the Commission required such a showing in past cases?**

25 A. No. Staff and RUCO have made similar arguments in the past – and they have been
26 rejected. For example, in the Bella Vista water rate case, the utility requested inclusion of
27 numerous system improvement projects into rate base as post test year plant. Staff and

1 RUCO argued that the plant should be excluded, because the plant “may improve system
2 reliability resulting in lower expenses and increased revenues.”¹ The Commission rejected
3 this argument, noted that while plant constructed to serve existing customers could have
4 some impact on revenues or expenses, the evidence did not show a **material impact** on
5 revenues and expenses.²

6
7 Along similar lines, in an Arizona Water Company rate case the Commission explained
8 that “inclusion of post test year plant always causes some mismatch between revenues and
9 expenses, even if the post test year plant is revenue neutral.”³ The Commission
10 nevertheless included the post test year plant in rate base. The Commission emphasized
11 materiality again in a Rio Rico rate case, noting that “there would not be a material impact
12 on revenue or expenses.”⁴

13
14 **Q. Will any impact on revenue and expenses be material?**

15 A. No. The post test year plant we are requesting in rate base will not have a material impact
16 on revenue or expenses.

17
18 **Q. Did Staff or RUCO provide any evidence regarding increased revenue or decreased
19 expenses?**

20 A. Staff simply makes an unsubstantiated assumption that revenue or expenses will be
21 impacted. Mr. Smith, for RUCO, points to UNS Gas’s Response to RUCO data request
22 11.28.⁵ UNS Gas stated that expenses “could” be reduced. The Response does not state
23 that a reduction is likely, or that it would be material. Moreover, Mr. Smith fails to
24 mention UNS Gas’ response to RUCO 11.18.b, which notes that overall expense levels

25

1 Decision No. 65380 (Nov. 1, 2002) at 9:15.

2 Decision No. 65380 (Nov. 1, 2002) at 10.

3 Decision No. 68176 (Sept. 30, 2004) at 5:12-13.

4 Decision No. 67279 (Oct. 5, 2004) at 7.

5 Smith Surrebuttal at 12.

1 have increased since the test year. Notably, neither Staff nor RUCO have testified that any
2 impact to revenue or expenses would be material – as required by prior Commission
3 decisions.

4
5 **Q. What else do Staff and RUCO point to?**

6 A. They argue that post test year plant should only be approved in “compelling”⁶ or “very
7 compelling”⁷ circumstances. But the Commission has rejected such arguments before.
8 For example, in Decision No. 65350, the Commission stated that “We do not agree with
9 Staff and RUCO that the Commission has always required extraordinary circumstances to
10 allow post test year plant.”⁸

11
12 **Q. What criteria has the Commission established?**

13 A. The Commission summarized its past cases as follows: “In the past, the Commission has
14 allowed the inclusion of post test year plant in circumstances where the new plant is
15 revenue neutral and there is no evidence of a material mismatch between revenue and
16 expenses and where the post test year plant is required for system reliability or to provide
17 adequate service.”⁹

18
19 **Q. Does UNS Gas’s requested post test year plant satisfy these criteria?**

20 A. Yes. The post test year plant is plant that whose primary purpose is to serve existing
21 customers and which would have been replaced regardless of customer growth.¹⁰ As I
22 have explained, there will not be a material impact on revenue or expenses.

23
24
25

⁶ Fish Surrebuttal at 2:19.

26 ⁷ Smith Surrebuttal at 17:9.

27 ⁸ Decision No. 65350 (Nov. 1, 2002) at 11:21-23.

⁹ Decision No. 67279 (Oct. 5, 2004) at 6:7-10.

¹⁰ See UNS Gas Response to RUCO 11.30.c (Attached to Smith Surrebuttal Testimony).

1 **Q. What else does RUCO argue?**

2 A. Mr. Smith argues that UNS Gas is not a water company, and past examples of post test
3 year plant have been for water companies. True, but water company rates are set by the
4 same principles and methods – matching, prudence, rate base, operating expenses, return
5 on equity, etc. And many of the decisions involve large, sophisticated “Class A” water
6 companies like Arizona-American, Arizona Water, and Chaparral City. All three of those
7 companies are part of multi-state utility holding companies. Clearly, allowing post test
8 year plant is not a policy limited to small, financially fragile water companies.

9
10 **B. Customer Advances.**

11
12 **Q. Has the basis for Dr. Fish and Mr. Smith’s removal of the Company’s Customer**
13 **Advances adjustment changed?**

14 A. No. Their arguments continue to be that that Customer Advances are non-investor supplied
15 capital and that is the required treatment based on the sample schedule B-1, Commission
16 rule A.A.C R 14-2-103.

17
18 **Q. Do you agree with Dr. Fish and Mr. Smith’s position that customer advances are non-**
19 **investor supplied capital?**

20 A. Yes. That is why I have included all of the customer advances as of the end of the test
21 year as **reduction** of rate base except for the small portion already expended by the end
22 of the test year on projects not included within rate base. I am only asking that the
23 Commission allow that small portion of cash advances not be deducted from rate base.
24 Throughout the testimonies of Dr. Fish and Mr. Smith they speak of matching, but they
25 fail to follow that principle for these advances. As I explained in my Rebuttal Testimony,
26 Dr. Fish’s and Mr. Smith’s approach creates a mismatch between when plant-in-service is
27 measured, and when the advances are measured. And this mismatch has the result of

1 eliminating from rate base pre-existing plant funded by investors. It's simply a mismatch
2 to reduce rate base for these advances relating to plant that, as of the end of the test year,
3 is not in service or in rate base. Staff's and RUCO's method amounts to reducing the
4 return on and of investor-supplied capital.

5
6 **Q. Do the Commission's rules forbid UNS Gas's request?**

7 A. No. Staff and RUCO suggest that Rule 103 (A.A.C. R14-2-103) compels a ruling in their
8 favor. In the past, Staff and RUCO have made similar arguments about post test year
9 plant – that it is forbidden by Rule 103. The Commission has repeatedly rejected such
10 arguments, finding that the Commission can approve adjustments to rate base
11 notwithstanding Rule 103.¹¹

12
13 **Q. What about Mr. Smith's concern that UNS Gas does not reduce CWIP by**
14 **Customers Advances prior to calculating AFUDC?**

15 A. UNS Gas is not arguing for advances to be excluded as a reduction in rate base – UNS
16 Gas is arguing for recovery of and on rate base properly invested in by the Company to
17 serve customers. The projects funded by the advances UNS Gas is asking to exclude are
18 not in rate base, not accruing AFUDC and historically over 80% of all advances are
19 returned to the developers and never become contributions at all. The very minor amount
20 of AFUDC that was accrued on the advance portion of these projects during their short
21 construction period is only a fraction of the lost return on and of rate base being denied to
22 UNS Gas.

23
24
25
26
27

¹¹ Decision No. 66849 (March 19, 2004) at 4:18-20; Decision No. 65350 (Nov. 1, 2002) at 10:10-12.

1 **C. Cash Working Capital.**

2
3 **Q. Do the other parties still disagree with the Company's cash working capital**
4 **calculation?**

5 A. Yes. Dr. Fish argues that the payment terms agreed to by the Company with its largest
6 natural gas supplier are not reasonable or representative of normal credit terms.

7
8 **Q. Do you agree with Dr. Fish?**

9 A. No. The necessity and prudence of the payment terms is being addressed by the Mr.
10 Grant's Rejoinder Testimony.

11
12 **Q. Did Mr. Smith address your revised Cash Working Capital adjustment in his**
13 **Surrebuttal testimony?**

14 A. Yes. Mr. Smith contends that the Company's proposed change to the purchased gas
15 payment lag reaches outside of the test year and that we have not demonstrated that the
16 change is permanent.

17
18 **Q. Would you like to address Mr. Smith's contentions?**

19 A. Yes. The altered payment terms began during the test year and my adjustment is
20 essentially an annualization of that change – which is not really any different than
21 annualizing for any other change that happens either to reduce or increase cost of service.
22 The change happened during the test year, and then again the following winter. And
23 according to those within the Company that manage the credit and payment terms, the
24 change will be true again this winter. As far as being permanent – I am not sure that it is
25 possible to deem any expense item or cost as permanent. But, by all reasonable standards
26 it is recurring, known and measureable.

1 **D. Reconstruction Cost New Depreciated ("RCND").**

2
3 **Q. Do you have any comments on the RCND study discussions by Staff in its**
4 **Surrebuttal?**

5 A. Yes. After re-evaluating our analysis, I need to revise my discussion on RCND. It appears
6 that we did not properly alter the trend rate in our comparison of our present method with
7 the study in the prior filing. If we alter the trend rate appropriately to be consistent with the
8 prior study the RCND value in our present study would come down. Therefore, Dr. Fish is
9 correct in his contention that the RCND value in this case is representatively higher in this
10 filing versus the prior filing. If the Mains category were re-stated to reflect cast iron trend
11 values the RCND would be \$19.6 million less than the original filed amount.

12
13 **Q. If the RCND value in your filing were adjusted to reflect the more conservative value**
14 **would it impact the requested increase of UNS Gas?**

15 A. No. As UNS Gas has limited its requested increase to \$9.5 million, although we could
16 support a greater request.

17
18 **III. REBUTTAL TO OPERATING INCOME ADJUSTMENTS.**

19
20 **A. Payroll and Payroll Tax Expense.**

21
22 **Q. Did RUCO continue its objection to the Company's payroll adjustments in its**
23 **Surrebuttal filing?**

24 A. Yes. Mr. Smith argues that there are compelling circumstances in the context of the
25 current UNSG rate case, including the poor economic climate that warrant differing
26 treatment then Southwest Gas, UNS Electric and TEP were afforded in their last rate cases.

1 He also offers some information on a few utilities in other states that have forgone or
2 limited non-bargaining employee wage rate increases.

3
4 **Q. Would you like to comment on Mr. Smith's assertion that perhaps UNS Gas should**
5 **not be allowed recent Commission treatment for pay rate increases because of the**
6 **present economic conditions?**

7 A. Yes, I would. UNS Gas understands that this is a difficult time. We are sympathetic to our
8 customers. That is why we have proposed limiting our rate increase to \$9.5 million when
9 we could justify a larger increase. And that is why we proposed exempting our low
10 income customers from the base rate increase.

11
12 We took these actions due to the concern for low income customers. Such explicit
13 measures are preferable to artificially pretending that certain necessary costs will not
14 occur. The employee levels as of the end of the test year are known, as are the wage
15 increases.

16
17 Further, the present process usually benefits the customers in that rates are set based on
18 historical information and payroll costs generally increase. For example, the present rates
19 in effect were set based on a calendar year 2005 adjusted for a 2006 pay rate increase. The
20 customers have benefited from not having wage increases reflected in rates attributable to
21 the increased payroll cost paid by the Company in 2007, 2008 or 2009.

22
23 **Q. What about Mr. Smith's contention that some other utilities are forgoing at least**
24 **some portion of wage increases in rate filings in other jurisdictions?**

25 A. Without a complete understanding of the circumstances in each of those rate filings and
26 specific ratemaking treatment in those other jurisdictions, it would be difficult to weigh the
27 relevance of the examples he cites. We just don't know the specific circumstances.

1 Moreover, as noted above, UNS Gas has taken a number of steps to protect our customers,
2 especially our low income customers.

3
4 **B. Call Center Expense.**

5
6 **Q. Did Staff address its Call Center expense adjustment?**

7 A. Yes. Staff witness Dr. Fish reiterated his assertion that UNS Gas test year call center
8 expense had increased by too much relative to the amount approved in the last filing. Dr.
9 Fish asserts that UNS Gas has not substantiated the increased cost.

10
11 **Q. Do you agree with Dr. Fish's assertions?**

12 A. No. In my Rebuttal Testimony I provided substantial information regarding the fact that
13 call center cost had only increased 22% since 2005 despite continual additions of services
14 and new equipment. In Dr. Fish's own Surrebuttal testimony he states, "The issue is really
15 not the allocation method, but that the call center costs seem to be increasing at an
16 alarming rate." Well as I point out in my Rebuttal Testimony, the cost of the call center is
17 not the driver of the increase to UNS Gas – it is cost allocation. Simply put, the customers
18 of UNS Gas are using substantially more of the call center resources than were allocated to
19 them in the last UNS Gas rate case. As I explained in my Rebuttal Testimony, call
20 volume from UNS Gas customers has increased, as has call duration. Further, the call
21 center has added additional services for our customers, such as credit card processing and
22 on-line bill presentment. It is not reasonable to limit UNS Gas to 2005 call center expense
23 levels, when call volume, call duration and services have all increased.

1 **C. Bad Debt Expense.**

2
3 **Q. Did Staff address pro forma bad debt expense in Surrebuttal?**

4 A. Yes. Dr. Fish reiterated the Commission's position that allowance for doubtful accounts
5 had increased from \$366,000 to \$1,220,000, which is an increase of 300 percent. He then
6 goes on to misconstrue my Rebuttal testimony by saying that, "Mr. Dukes suggests that he
7 takes offense that Staff might question the appropriateness of the reserve for bad debt, but
8 he believes it is reasonable to fail to recognize losses in a timely manner."

9
10 **Q. Do you have any additional comments to make on the bad debt expense testimony of**
11 **Dr. Fish?**

12 A. Yes. Dr. Fish wants you to focus on one side of the ledger and ignore the other. My
13 comment in Rebuttal of taking offense is not based on the balance of the allowance
14 account, but the assertion that Dr. Fish is making that we have "overstated bad debt
15 expense" in the neighborhood of \$700,000 sometime in the last three years. His argument
16 to reduce pro forma bad debt expense only makes sense if he is arguing that we over
17 expensed in the last three years, thus overstating our allowance account and thus our
18 historical write-off percentage being applied to pro forma revenue – which in turn would
19 overstate pro forma bad debt expense.

20
21 The problem with that whole argument is that it simply ignores the facts and the
22 information I provided in my rebuttal testimony and in response to data requests. The
23 allowance account is not overstated because of the over expensing of bad debt. The
24 allowance account is higher to reflect the fact that accounts receivable has a higher amount
25 of uncollectible accounts that have not been written off. When you write off uncollectible
26 accounts there is no impact on the income statement – the expense impact was recognized
27 when the revenue was recorded. When you write off uncollectible accounts you simply

1 reduce accounts receivable and reduce allowance for doubtful accounts by equal amounts.
2 That is why these two accounts are not mutually exclusive; the true accounts receivable
3 balance is the net of accounts receivable and allowance for doubtful accounts.
4

5 In December 2005, the accounts receivable balance of UNS Gas was just over \$12 million,
6 and only \$181,514 in accounts over 90 days were past due. But in June 2008, the accounts
7 receivable account was just over \$7 million, but had over \$1,216,156 in accounts 90 days
8 past due included within it. That is why the allowance account is so much higher – not
9 overstated bad debt expense.
10

11 **D. Outside Legal Expense.**
12

13 **Q. Did Staff address pro forma outside legal expense in their Surrebuttal?**

14 A. Yes. Staff witness Dr. Fish stated that I provided no substantive reasons for the high level
15 of legal expenses being requested in our filing.
16

17 **Q. Do you agree with Dr. Fish's assessment?**

18 A. No. UNS Gas provided significant support for its request. Besides the fact that my
19 adjustment is based on actual historical expense levels and the information I provided in
20 my Rebuttal testimony, UNS Gas provided responses to a multitude of data requests
21 providing additional support for its requested level of expense. Those responses included
22 projected legal costs that are much closer to UNS Gas's proposed expense level than the
23 artificially low, anomalous levels proposed by Staff.
24

25 **Q. What about RUCO?**

26 A. Mr. Smith continues to oppose the pro forma level of outside legal cost being requested by
27 UNS Gas. Mr. Smith essentially argues that the level of outside legal expenditures has

1 declined since the last rate case and that circumstances have changed with some additional
2 level of expenditure sharing in EPNG FERC cases with TEP. He offers a significantly
3 reduced level of pro forma expense \$171,865, which is \$88,310 more than the level
4 proposed by Staff, but \$217,674 less than the Company's request which is based on
5 historical spending levels.

6
7 **Q. Do you agree with Mr. Smith's assessment?**

8 A. No, but Mr. Smith has raised a valid issue with the sharing of cost of EPNG application
9 monitoring with TEP. But this issue will not have as great a near term impact because the
10 cost sharing with TEP does not apply to Transwestern (including is upcoming rate case)
11 because TEP is not a customer of Transwestern. However, the sharing of the cost for
12 EPNG monitoring should be considered as a potential reduction of future outside legal cost
13 levels for UNS Gas.

14
15 **Q. So do you believe that your pro forma outside legal cost should be reduced?**

16 A. At this time I do not have any known and measureable information to support a reduction
17 to the historical average level, however if the Commission were to compromise between
18 RUCO's position and the Company's I could support such a proposal and we would
19 monitor closely how the sharing impacts future cost levels and adjust accordingly in our
20 next rate filing.

21
22 **Q. What about the issues not addressed in this rejoinder testimony?**

23 A. All those issues remain the same as stated in my rebuttal testimony, and UNS Gas has not
24 changed is position on any of those issues.

25
26 **Q. Does this conclude your Direct Testimony?**

27 A. Yes, it does.

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 **COMMISSIONERS**

3 KRISTIN K. MAYES - CHAIRMAN

4 GARY PIERCE

5 PAUL NEWMAN

6 SANDRA D. KENNEDY

7 BOB STUMP

8 IN THE MATTER OF THE APPLICATION OF) DOCKET NO. G-04204A-08-0571
9 UNS GAS, INC. FOR THE ESTABLISHMENT)
10 OF JUST AND REASONABLE RATES AND)
11 CHARGES DESIGNED TO REALIZE A)
12 REASONABLE RATE OF RETURN ON THE)
13 FAIR VALUE OF THE PROPERTIES OF UNS)
14 GAS, INC. DEVOTED TO ITS OPERATIONS)
15 THROUGHOUT THE STATE OF ARIZONA.)

16 Rejoinder Testimony of

17 D. Bentley Erdwurm

18 on Behalf of

19 UNS Gas, Inc.

20 August 5, 2009

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1 **I. INTRODUCTION.**

2
3 **Q. Please state your name and address.**

4 A. My name is D. Bentley Erdwurm. My business address is One South Church Avenue,
5 Tucson, Arizona 85701.
6

7 **Q. Did you file Direct and Rebuttal Testimony in this proceeding?**

8 A. Yes.
9

10 **Q. On whose behalf are you filing your Rejoinder Testimony in this proceeding?**

11 A. My Testimony is filed on behalf of UNS Gas, Inc.
12

13 **Q. What is the purpose of your Rejoinder Testimony in this proceeding?**

14 A. The purpose of my Rejoinder Testimony is to address the Arizona Corporation
15 Commission ("Commission") Staff's and the Residential Utility Consumer Office's
16 ("RUCO") Rebuttal Testimony on (i) the customer annualization adjustment, and (ii) UNS
17 Gas' proposal for phased-in residential customer charge increases over a two-year period
18 after rate implementation.
19

20 **II. CUSTOMER ANNUALIZATION ADJUSTMENT.**

21
22 **Q. Please summarize RUCO's concern about the Company's proposed customer
23 annualization adjustment.**

24 A. RUCO witness Ralph C. Smith states that it does not make sense to reduce test-year
25 revenue when UNS Gas has continued to experience year-over-year customer growth.
26
27

1 **Q. Do you agree with Mr. Smith's contention?**

2 A. Not at all. This result is an expected consequence of the application of the traditional
3 approach to customer annualization. And it is not just expected; the result is entirely
4 appropriate, in the public interest, and necessary to ensure equitable and consistent
5 treatment of the parties to this proceeding.
6

7 **Q. Please explain.**

8 A. UNS Gas has in this proceeding proposed the exact methodology approved the
9 Commission and supported by Staff and RUCO in the 2006 Case. This methodology is
10 well-established in Arizona and elsewhere. I have been calculating customer annualization
11 adjustments using this simple method since early 1982 when I was employed by the Public
12 Utility Commission of Texas.
13

14 Under the traditional approach to customer annualization, customer counts are adjusted to
15 test-year-end levels. The traditional approach is simple, and does not attempt to remove
16 the effects of seasonality. Mr. Smith states the obvious with his observation that "the
17 decrease in revenue produced by the Company's calculation appears to be related to
18 customer seasonality rather than a permanent decline in customer count during the test
19 year." (Smith Surrebuttal, page 38, lines 8-11.) Since UNS Gas adds seasonal customers
20 in the winter and loses them in the summer, the traditional method of customer
21 annualization yields relatively larger customer annualization adjustments (that tend to
22 lower rates) for winter-ending test years and relatively smaller customer annualization
23 adjustments (that tend to increase rates) for summer ending test-years – as we had in this
24 proceeding (test year ended June 30, 2008) – as compared to approaches that remove the
25 effects of seasonality. The application of the traditional approach to customer count data
26 for the test-year ended June 30, 2008 – data that exhibits both seasonality and an
27

1 insignificant underlying growth rate - results in a negative customer annualization in this
2 case.

3
4 Equity dictates that these customer annualization results be compared to the results of the
5 2006 Rate Case, which had a winter-ending test-year (December 31, 2005). In the 2006
6 Rate Case, use of the traditional approach resulted in larger customer annualization
7 adjustment (which resulted in lower rates) than would an adjustment based on an approach
8 removing seasonality. Because of seasonality, actual December customer counts – which
9 are the basis for the customer annualization adjustment – were relatively high because of
10 the presence of seasonal customers. Neither Staff nor RUCO witnesses were concerned
11 about seasonality in the 2006 Case when seasonality reduced UNS Gas' rate increase. In
12 fact, Mr. Smith, then a Staff witness, argued in favor of the use of the traditional approach
13 because it is straight-forward and transparent.¹ RUCO's witness in the 2006 Case,
14 Marylee Diaz-Cortez, claimed that the seasonality was not extreme enough to "depart from
15 the 'traditional' or **Commission-accepted** (*emphasis added*) methodology of revenue
16 annualization."²

17
18 RUCO – and Staff -- seem determined to oppose the use of the traditional approach when
19 it does not reduce rates. It is unfortunate that Staff and RUCO are permitting the final
20 result – whether rates are increased or reduced – to determine their choice of customer
21 annualization methodology. However, sometimes the traditional and accepted customer
22 annualization approach results in smaller customer annualization adjustments and
23 sometimes it results in larger customer annualization adjustments – as compared to
24 alternate methods adjusting for seasonality. So sometimes application of the traditional

25
26 ¹ 2006 Case, Smith Surrebuttal, page 20, lines 15-22.

27 ² See Diaz-Cortez Surrebuttal, Docket No. G-04204A-06-0463, page 12, lines 20-23, see also
Decision No. 70011 (November 27, 2007) at page 18, lines 18-20.

1 adjustment increases rates, and sometimes it decreases rates. This is an equitable result.
2 Over time, things balance out if the traditional approach is used consistently.
3

4 **Q. Why did you not in this case propose an alternate customer annualization?**

5 A. In the 2006 Case, I did propose such an approach. However, the approach was opposed by
6 both Staff and RUCO, and the Commission opted to maintain the traditional approach in
7 Decision No. 70011. I accepted that the Commission preferred the traditional approach
8 over my proposed approach; therefore, I used the traditional approach in this pending case.
9 The use of the traditional approach in this pending case is consistent with Decision No.
10 70011, as well as numerous previous gas rate cases in Arizona.
11

12 **Q. Mr. Smith criticizes your “rote” application of the traditional approach in this**
13 **pending case. (Smith Surrebuttal, page 38, lines 6-8). Please comment.**

14 A. For Mr. Smith, avoidance of “rote application” seems to be code for a “heads I win, tails
15 you lose” approach that is biased against UNS Gas. Moving back and forth between
16 methodologies – looking for an end result of the lowest possible rates – does not result in
17 just and reasonable rates, is inequitable and is not in the public interest.
18

19 **Q. In the prior UNS Gas rate case, you proposed an annualization approach that made**
20 **an adjustment to address seasonality. Why are you opposed to Staff witness Dr.**
21 **Thomas Fish’s customer annualization approach, which also attempts to take**
22 **seasonality into account?**

23 A. Dr. Fish’s unorthodox approach does not simply seek to remove the impact of seasonality
24 within the historic test year – which is what I suggested in the last rate case. Instead, he
25 amplifies seasonality by first adjusting customer counts to relatively high December 2007
26 customer levels and then inflating them further by applying an inappropriate growth factor.
27 This approach is wholly inconsistent with the historic test year requirement.

1 Indeed, Dr. Fish's approach acts as a "double whammy" against UNS Gas. Adjusting to
2 December levels *even without the growth factor* is inappropriate. December is not test-
3 year end and the choice of December as an adjusting point appears an attempt to maximize
4 the size of the customer annualization adjustment by adjusting to a seasonal peak.
5 Increasing the December count by the growth factor rubs salt in the wound. The flaws in
6 Dr. Fish's approach are many; they have been extensively discussed in my Rebuttal
7 Testimony. In my Rebuttal Testimony, I explain that Dr. Fish is effectively using a future
8 test-year approach to customer annualization but has failed to coordinate the revenue
9 element of the ratemaking formula with expenses, rate base, and other components
10 affecting rates. In short, he has violated the matching principle.
11

12 **Q. Did Dr. Fish's Surrebuttal Testimony address some of your concerns?**

13 A. No. I became even more concerned because of his continued attempts to salvage his
14 flawed customer annualization adjustment. Dr. Fish is attempting to forecast customer
15 counts. And a customer annualization adjustment is not identical to a forecast. The fact
16 that he claims to have used historical data to reach his result is inconsequential to the
17 question of whether he is forecasting. The most straightforward way to ascertain whether
18 he is forecasting is to look at the adjusted customer counts that are the basis for his
19 customer annualization adjustment. The customer counts to which Dr. Fish is adjusting
20 exceed all historical regular residential and small volume commercial customer counts.
21 Even one year after the end of the test-year, these customer count levels still have not been
22 reached. In light of these results, we can say absolutely and unambiguously that the
23 customer counts to which Dr. Fish are adjusting are not historical values. Either the
24 customer counts to which Dr. Fish are adjusting are *future* customer counts to be realized
25 at some indeterminate time, or they are customer counts that will never be realized, but
26 they are certainly not historical data.
27

1 Finally, Dr. Fish defends his use of the growth rate applied to December customer counts
2 by arguing that the growth rate was supplied by UNS Gas. However, UNS Gas never
3 advised Dr. Fish that it should be used in calculating the customer annualization
4 adjustment. Dr. Fish picked a growth rate more consistent with speculative forecasting and
5 not the calculation of customer annualization adjustments. Mr. Hutchens in his Rejoinder
6 Testimony explains in more detail why the prior growth estimate is no longer valid.

7
8 **III. PHASED-IN RESIDENTIAL CUSTOMER CHARGE.**

9
10 **Q. Please address the issue of the phased-in residential customer charge.**

11 A. UNS Gas' proposed phase-in of residential customer charge increases is an attempt to
12 better align rates with cost-of-service without causing undue confusion or rate shock.
13 UNS Gas' class cost-of-service study supports the increase. Having prices track cost is
14 necessary for customers to make good economic decisions about resource use. Finally,
15 from the standpoint of UNS Gas, having higher cost-based residential charges brings
16 revenue recovery more in line with cost incurrence. Currently, UNS Gas' residential
17 non-commodity (i.e., excluding the recovery of gas costs) revenue is recovered
18 predominantly through volumetric energy charges (\$/therm) as opposed to customer
19 charges, whereas the lion's share of costs are fixed. Recovering fixed costs
20 volumetrically through energy charges invariably leads to over-recovery or under-
21 recovery of cost. A more appropriate recovery of fixed costs through customer charges
22 promotes a matching of revenue collection with cost incursion.

23
24 Moreover, UNS Gas' proposal to gradually phase-in its higher fixed monthly charge in a
25 revenue neutral manner serves an important emerging public policy. This rate design will
26 help ensure that UNS Gas' financial incentives are aligned with helping its customers use
27 energy more efficiently. It is an initial and gradual move towards de-coupling.

1 **Q. Please address the issue of customer confusion and rate shock.**

2 A. RUCO witness Frank F. Radigan in his Surrebuttal Testimony has expressed a concern
3 that the phased in customer charges will cause customer confusion and he has noted that
4 these customer charges will increase in percentage terms more than other rate
5 components. As I have stated in my Rebuttal Testimony, too much emphasis is placed
6 on percentage increases relative to absolute increases. Most customers are more
7 concerned with total dollars paid for service, and are unconcerned with whether revenue
8 is collected through a customer charge or a therm (volumetric / energy) charge.

9
10 The current residential customer charge is \$8.50, which UNS Gas proposes to increase to
11 \$10.00 at rate implantation, to \$12.00 one year after rate implementation, and to \$14.00
12 two years after rate implementation. Subsequent to the initial customer charge increase
13 to \$10.00, the phased increases result in a (i.e. over two year phase-in period) \$4.00
14 increase in the customer charge. One should remember that each customer charge
15 increase is coupled with a therm charge *decrease*. For the average residential customer,
16 the increased monthly customer charges will be exactly offset over the year (because of
17 revenue neutral rate design over the class) by decreased therm charges. The maximum
18 bill increase in the two year phase-in period subsequent to the initial rate implementation
19 will be \$4.00 per month, and that is for an unusual case where there is a customer with no
20 usage.

21
22 Moreover, this rate design helps to mitigate inequitable subsidies to some extent. I have
23 previously discussed how gas usage varies over the UNS Gas system because of the
24 different climate zones the Company serves. Because of the currently inadequate
25 customer charges, customers in cooler climates (who use more gas in the winter) are
26 subsidizing customers in warmer zones. I do not believe that a geographical cost of
27

1 service study – suggested by Mr. Radigan - is required to justify the customer charge
2 increases that will help mitigate this problem.

3
4 **Q. Please explain why the matching of revenue to cost incursion is important to UNS**
5 **Gas.**

6 A. As explained above, the majority of UNS Gas' costs are fixed, but the majority of our
7 revenues are collected volumetrically through charges expressed in \$/therm. This leads
8 to under-recoveries when sales are relatively low regardless of whether low sales are
9 attributable to weather, the economy, conservation and energy efficiency or other factors.
10 Likewise, over-recoveries result when sales are relatively high. Increasing the customer
11 charge will help mitigate periodic swings in revenue because of volatility in usage.

12
13 **Q. Could the customer charge increase have implications for conservation and energy**
14 **efficiency programs?**

15 A. Absolutely. Under the current rate structure, sales reductions due to conservation and
16 energy efficiency mean margin loss to UNS Gas. This is bad public policy. The
17 Commission should move toward a rate framework that will align all stakeholders' self-
18 interests with its growing commitment to conservation and energy efficiency. UNS Gas
19 needs rate mechanisms that will facilitate our transition from a seller of product (where
20 our self-interest is promoted by increasing sales) to provider of service (where the
21 promotion of conservation has no negative impact on our financial condition). Customer
22 charge increases are one of the simplest ways to move away from profitability tied to
23 sales and our proposed rate design helps start the movement towards appropriate de-
24 coupling.

25
26 **Q. Does this conclude your Rejoinder Testimony?**

27 A. Yes, it does.